

Message Text

CONFIDENTIAL

PAGE 01 LONDON 19782 01 OF 03 081320Z

44

ACTION SS-14

INFO OCT-01 ISO-00 SSO-00 EB-03 EUR-08 SP-02 TRSE-00 NSC-05

NSCE-00 FRB-03 CIAE-00 ONY-00 /036 W

----- 042448

O 081309Z DEC 76

FM AMEMBASSY LONDON

TO SECSTATE WASHDC IMMEDIATE 8532

C O N F I D E N T I A L SECTION 01 OF 03 LONDON 19782

LIMDIS WITH DISTRIBUTION FOR S, C, D, E, P, EB, EUR,
S/P, TREASURY, NSC, FRB ONLY

E.O. 11652: GDS

TAGS: EFIN, UK

SUBJECT: SITUATION REPORT, DECEMBER 8

REF: (A) STATE 267168; (B) LONDON 19694

FOREIGN PRESS ASSOCIATION LUNCHEON, SAID HE HOPED THAT DECISIONS WILL BE ANNOUNCED IN A WEEK'S TIME "WHICH WILL GIVE STERLING A STABILITY OVER A LONG PERIOD." HE HOPED AGREEMENT IN PRINCIPAL ON A SOLUTION TO THE PROBLEM OF STERLINL BALANCES COULD BE ANNOUNCED AT THE SAME TIME AS NEXT WEEK'S ECONOMIC MEASURES, NOW SCHEDULED TO BE PRESENTED TO PARLIAMENT ON THE EVENING OF WEDNESDAY, DECEMBER 15. THE PRESS SPECULATES THAT PROGRESS IS BEING MADE INTERNATIONALLY ON AT LEAST A DECLARATION OF INTENT ABOUT TALKS ON THE FUTURE OF THE BALANCES ALTHOUGH THE DETAILS ARE NOT LIKELY TO BE RESOLVED UNTIL EARLY NEXT WEEK.

CABINET DISCUSSIONS CONTINUED YESTERDAY ON THE CONTENTS OF THE ECONOMIC PACKAGE TO BE ANNOUNCED. THE CABINET REPORTEDLY MET FOR THREE HOURS YESTERDAY MORNING AN'D RESUMED ITS SESSION LAST NIGHT. ACCORDING TO AN INFORMED SOURCE, WHAT THE CABINET IS DISCUSSING IS A PACKAGE CONSISTING OF EXPENDITURE CUTS OF 1 BILLION POUNDS PLUS SAVINGS ON INTEREST COSTS OF 500 POUNDS.
CONFIDENTIAL

CONFIDENTIAL

PAGE 02 LONDON 19782 01 OF 03 081320Z

THE GUARDIAN REPORTS THAT THE POSSIBLE SALE OF BRITISH

PETROLEUM SHARES WORTH SOME 500 MILLION POUNDS IS LIKELY TO BE DROPPED IN THE FACE OF WIDE OPPOSITION TO THE IDEA BOTH IN CABINET AND AMONG BACK BENCHERS. SUCH A SALE WAS RUMOURED TO BE PART OF THE PACKAGE TO REDUCE THE PUBLIC SECTOR BORROWING REQUIREMENT. OBJECTIONS TO THE SALE CENTERED ON THE LOSS OF ONE OF THE FEW PROFIT-ABLE NATIONALLY OWNED ENTERPRISES JUST WHEN NORTH SEA AND ALASKA PROFITS WERE BEGINNING TO FLOW. FURTHERMORE, THE INTERPRETATION GIVEN TO MONDAY'S STATEMENT BY ROBERT SHELDON (SEE YESTERDAY'S SITUATION REPORT), APPARENTLY RULING OUT INCREASES IN VAT AND EXCISE DUTIES, IS BEING TERMED POSSIBLY INCORRECT.

THE ULTIMATE DECISION WILL DEPEND ON HOW SUCCESSFUL MINISTERS ARE IN AGREEING TO PUBLIC SPENDING CUTS OF ABOUT 1 BILLION POUNDS IN 1977/78. IF THERE IS A GAP, IT COULD BE MADE UP BY INDIRECT TAX INCREASES.

THE PRIME MINISTER HAS CONTINUED TO DEFEND HIS LIMITED FREEDOM OF MANEUVER IN THE AREA OF ECONOMIC POLICY OPTIONS. IN THE COMMONS, THE PRIME MINISTER WENT OUT OF HIS WAY TO STRESS THAT NO SOFT OPTIONS ARE AVAILABLE TO THE GOVERNMENT IN REDUCING THE SIZE OF THE PSBR AND THAT THE RESULTS WOULD BE PAINFUL. HE REFUSED TO GIVE ASSURANCES THAT SPENDING ON SOCIAL SERVICES AND OTHER "SACRED COWS" WOULD BE SPARED FROM REDUCTION. CALLAGHAN DENIED THAT MEASURES UNDER CONSIDERATION COULD BE CHARACTERIZED AS PROPOSALS FOR SAVAGE DEFLATION BUT HE DID ADMIT THAT THE DEFINITION OF SAVAGE WAS ALL IMPORTANT.

AN INFORMED SOURCE SAYS CALLAGHAN IS (PRIVATELY) EXPLAINING THAT HIS DECISION FINALLY TO SIDE WITH THE "CUTTERS" WAS FOUNDED ON THE ISSUE OF CONFIDENCE.

THE TIMES SAYS THAT CALLAGHAN ERODED THE POSITION OF THE "ANTI-DEFLATIONISTS", INCLUDING THE CROSLAND-LEVER GROUP AS WELL AS THE LEFT, "WHICH HAD BEEN BASED ON THE ARGUMENT THAT THE MAIN WAY TO OVERCOME BRITAIN'S ECONOMIC DIFFICULTIES WAS AN INTERNATIONAL LOAN WHICH

CONFIDENTIAL

PAGE 03 LONDON 19782 01 OF 03 081320Z

WOULD PROVIDE A 'SAFETY NET' BY PROTECTING...STERLING BALANCES. THE PRIME MINISTER IS UNDERSTOOD TO HAVE TOLD HIS COLLEAGUES THAT BOTH...SCHMIDT...AND...SIMON... HAD TOLD HIM THEY WOULD EXPECT A DEFLATIONARY PACKAGE FROM BRITAIN. WHETHER THAT WAS IN THE CONTEXT OF AN AGREEMENT TO RAISE AN INTERNATIONAL LOAN TO UNDERPIN BRITAIN'S STERLING BALANCES IS NOT KNOWN, BUT IT WAS BEING SAID LAST NIGHT THAT AFTER MR. CALLAGHAN'S STATE-

CONFIDENTIAL

NNN

CONFIDENTIAL

PAGE 01 LONDON 19782 02 OF 03 081322Z

44

ACTION SS-14

INFO OCT-01 ISO-00 SSO-00 EB-03 EUR-08 SP-02 TRSE-00 NSC-05

NSCE-00 FRB-03 CIAE-00 ONY-00 /036 W

----- 042462

O 081309Z DEC 76

FM AMEMBASSY LONDON

TO SECSTATE WASHDC IMMEDIATE 8533

C O N F I D E N T I A L SECTION 02 OF 03 LONDON 19782

LIMDIS

MENT THE ANTI-DEFLATIONIST CAMP INSIDE THE CABINET WAS
IN DISARRAY."

2. MARKET SENTIMENT ON STERLING. STERLING ROSE 1.45
CENTS YESTERDAY ON CHANCELLOR HEALEY'S STATEMENT IN-
DICATING A POSSIBLE SOLUTION TO THE PROBLEM OF STERLING
BALANCES. HOWEVER, THE UNDERLYING MARKET TREND FOR
STERLING REMAINS NERVOUS AND CAUTIOUS. THERE WILL BE
UNCERTAINTY IN THE MARKET UNTIL THE PRECISE DETAILS OF
THE IMF PACKAGE ARE ANNOUNCED. TRADING SPREADS WHICH
WIDENED YESTERDAY FROM FIVE TO 20 BASIS POINTS AS
STERLING WENT UP IN THE MARKETS AGAINST OTHER CURRENCIES
WERE CITED AS AN INDICATION OF UNCERTAINTY IN THE
MARKETS, ALTHOUGH THE TRADE WEIGHTED DEVALUATION ALSO
IMPROVED, NARROWING FROM 45.4 AT MONDAY'S CLOSE TO 44.6
AT TUESDAY'S CLOSE. VOLUME HAS NOT BEEN HEAVY ALTHOUGH
RELATIVELY SMALL AMOUNTS STILL MOVE THE RATE NOTICEABLY.
NEITHER HAVE ANY LARGE SELLERS OR BUYERS BEEN OBSERVED.
THERE WAS SOME EXPECTATION THAT STERLING WOULD WEAKEN
THIS THURSDAY AS RESERVES WERE DEPLETED BY \$1.6 BILLION
TO REPAY THE CENTRAL BANK-U.S. TREASURY CREDIT LINE,
ALTHOUGH THE CHANCELLOR'S STATEMENT ABOUT A SOLUTION TO
THE STERLING BALANCES SEEMS TO HAVE COUNTERED THIS
POSSIBILITY. VIEWS ARE DIVIDED ABOUT THE MARKET IMPACT
OF THE IMF PACKAGE. THE MARKET GENERALLY SEEMS WILLING
TO GIVE THE UK THE BENEFIT OF THE DOUBT, PROVIDED THE

IMF DECLARES ITSELF SATISFIED WITH THE PROGRAM THAT THE
UK WILL INCLUDE IN ITS LETTER OF INTENT. HOWEVER, SOME
CONFIDENTIAL

CONFIDENTIAL

PAGE 02 LONDON 19782 02 OF 03 081322Z

SENIOR FOREIGN EXCHANGE DEALERS ARE TAKING AN "I'M FROM
MISSOURI" ATTITUDE, INDICATING THAT A REALLY CONVINCING
PROGRAM IS NEEDED AND QUESTIONING THE GOVERNMENT'S
POLITICAL WILL OR ABILITY TO SEE ONE THROUGH THE NEXT
TWO YEARS. IN EFFECT, THEY SAY THAT ON PAST HISTORY
AND PERFORMANCE, THERE ARE NO GROUNDS FOR OBJECTIVE
OPTIMISM. ALL THIS SAID, THE RUN UP TO THE END-OF-YEAR
HOLIDAY SEASON, WITH VACATIONS BEING TAKEN, AND END OF
YEAR WINDOW DRESSING, CLOSING OF POSITIONS AND TIDYING
UP LEADS TO A MARKET EXPECTATION THAT THERE WILL BE A
QUIET PERIOD AT LEAST THROUGH THE FIRST OR SECOND WEEK
IN JANUARY, DURING WHICH TIME THE UK PACKAGE WILL STAND
A BETTER CHANCE OF OBJECTIVE APPRAISAL THAN IF IT HAD
BEEN INTRODUCED DURING ANOTHER TIME DURING THE CALENDAR
YEAR.

3. BALANCE OF PAYMENTS. BRITAIN'S BALANCE OF PAYMENTS
DEFICIT NARROWED BY NEARLY 1.1 BILLION POUNDS IN THE
THIRD QUARTER OF 1976. THE IMPROVEMENT CAME FROM THE
CAPITAL ACCOUNT AS THE OUTFLOW OF OFFICIALLY HELD
STERLING BALANCES SLOWED SUBSTANTIALY; THEY WERE DOWN
TO 2.76 BILLION POUNDS AT THE END OF SEPTEMBER.
COMBINED CURRENT AND CAPITAL ACCOUNT DEFICIT LEFT A
GAP OF 848 MILLION POUNDS TO BE FINANCED FROM OFFICIAL
SOURCES. THIS WAS ACHIEVED BY A 309 MILLION POUND
DRAWDOWN OF SHORT TERM CREDITS MADE AVAILABLE BY
FOREIGN CENTRAL BANKS, BORROWING UNDER THE EXCHANGE
COVER SCHEME OF 492 MILLION POUNDS AND THE SALE OF 47
MILLION POUNDS FROM BRITAIN'S OFFICIAL RESERVES. THE
DATA ALSO REVEAL THAT BRITAIN DREW A TOTAL OF 1.545
BILLION DOLLARS OF THE 5.3 BILLION DOLLAR STANDBY CREDIT
FACILITY, DUE TO BE REPAID DECEMBER 9. FOR THE FIRST
THREE QUARTERS OF 1976 THE CUMULATIVE BALANCE OF PAY-
MENTS DEFICIT WAS 3.414 BILLION POUNDS OF WHICH 1.938
BILLION WAS IN THE CAPITAL ACCOUNT.

CONFIDENTIAL

NNN

CONFIDENTIAL

PAGE 01 LONDON 19782 03 OF 03 081324Z

44

ACTION SS-14

INFO OCT-01 ISO-00 SSO-00 EB-03 EUR-08 SP-02 TRSE-00 NSC-05

NSCE-00 FRB-03 CIAE-00 ONY-00 /036 W

----- 042499

O 081309Z DEC 76

FM AMEMBASSY LONDON

TO SECSTATE WASHDC IMMEDIATE 8534

C O N F I D E N T I A L SECTION 03 OF 03 LONDON 19782

LIMDIS

4. BANKING FIGURES - CREDIT SQUEEZE LIKELY. THE LATEST FIGURES ON BANK LENDING COVERING THE PERIOD THROUGH NOVEMBER 17 INDICATE THAT BANKS AS A GROUP HAD EXPANDED THEIR INTEREST BEARING ELIGIBLE LIABILITIES (IBELS) AT A RATE IN EXCESS OF THAT PERMITTED UNDER THE SO-CALLED CORSET REGULATIONS INTRODUCED IN MID-NOVEMBER. TO AVOID THE PENALTIES INVOLVED FOR OVER-SHOOTING THE ALLOWABLE IBELS GROWTH RATE OF 3 PERCENT, THE BANKS MAY HAVE TO REDUCE THEIR LENDING UNDER EXISTING CREDIT LINES AND PERHAPS REFUSE TO EXTEND NEW LOANS TO PERSONAL BORROWERS.

5. FOREIGN EXCHANGE AND FINANCE. AMID TECHNICAL INDICATIONS OF A POSSIBLE DROP IN THE MINIMUM LENDING RATE (MLR), THE GILT MARKET SHOWED EARLY STRENGTH. ENTHUSIASM WANED LATER IN THE DAY AS THE GOVERNMENT SIGNALLED THAT IT WAS NOT PREPARED TO SEE A DROP IN MLR. THE GOVERNMENT ALSO ANNOUNCED A NEW 500 MILLION POUND LONG TAP STOCK (GILT) TO REPLACE THE ISSUE SOLD OUT ON MONDAY.

THE FT INDEX OF 30 INDUSTRIALS ROSE 9.7 TO 319.8, ITS BEST LEVEL IN TWO MONTHS. VOLUME IMPROVED FROM THE LOW LEVELS WHICH HAVE CHARACTERIZED TRADING OF LATE.

STERLING ROSE TO \$1.6715 TUESDAY, A GAIN OF 1.45 CENTS ON THE DAY. THE MAIN INFLUENCE WAS THE
CONFIDENTIAL

CONFIDENTIAL

PAGE 02 LONDON 19782 03 OF 03 081324Z

CHANCELLOR-S REFERENCE TO PROGRESS ON STERLING BALANCES.
THE POUND OPENED TODAY AT \$1.6670.

ARMSTRONG

CONFIDENTIAL

NNN

Message Attributes

Automatic Decaptioning: Z
Capture Date: 01 JAN 1994
Channel Indicators: n/a
Current Classification: UNCLASSIFIED
Concepts: FINANCIAL STABILITY, CURRENCIES
Control Number: n/a
Copy: SINGLE
Draft Date: 08 DEC 1976
Decaption Date: 28 MAY 2004
Decaption Note: 25 YEAR REVIEW
Disposition Action: RELEASED
Disposition Approved on Date:
Disposition Authority: ElyME
Disposition Case Number: n/a
Disposition Comment: 25 YEAR REVIEW
Disposition Date: 28 MAY 2004
Disposition Event:
Disposition History: n/a
Disposition Reason:
Disposition Remarks:
Document Number: 1976LONDON19782
Document Source: CORE
Document Unique ID: 00
Drafter: n/a
Enclosure: n/a
Executive Order: RR
Errors: N/A
Film Number: D760453-0851
From: LONDON
Handling Restrictions: n/a
Image Path:
ISecure: 1
Legacy Key: link1976/newtext/t19761263/aaaacbwv.tel
Line Count: 278
Locator: TEXT ON-LINE, ON MICROFILM
Office: ACTION SS
Original Classification: CONFIDENTIAL
Original Handling Restrictions: ONLY, LIMDIS
Original Previous Classification: n/a
Original Previous Handling Restrictions: n/a
Page Count: 6
Previous Channel Indicators: n/a
Previous Classification: CONFIDENTIAL
Previous Handling Restrictions: ONLY, LIMDIS
Reference: 76 STATE 267168, 76 LONDON 19694
Review Action: RELEASED, APPROVED
Review Authority: ElyME
Review Comment: n/a
Review Content Flags: ANOMALY
Review Date: 13 MAY 2004
Review Event:
Review Exemptions: n/a
Review History: RELEASED <13 MAY 2004 by GarlanWA>; APPROVED <13 SEP 2004 by ElyME>
Review Markings:

Margaret P. Grafeld
Declassified/Released
US Department of State
EO Systematic Review
04 MAY 2006

Review Media Identifier:
Review Referrals: n/a
Review Release Date: n/a
Review Release Event: n/a
Review Transfer Date:
Review Withdrawn Fields: n/a
Secure: OPEN
Status: NATIVE
Subject: SITUATION REPORT, DECEMBER 8
TAGS: EFIN, ECON, UK
To: SECSTATE WASHDC
Type: TE
Markings: Margaret P. Grafeld Declassified/Released US Department of State EO Systematic Review 04 MAY 2006